

# Business & Economie

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## Summary

In April the business **regulatory framework** was marked by a series of laws, legislative projects and initiatives. The triple presidential initiative on the economy liberalization dominated the public debates throughout April eclipsing other important evolutions. The Constitutional Court declared as constitutional the provisions of the Regulation on the auto transportation of passengers and goods, stipulating to remove from use all re-equipped vans transporting passengers until the end of 2007. These provisions were contested by a Member of Parliament. It is difficult to imagine how the regulation will be applied, but any hasty interventions could generate severe social and economic consequences. In April, the government decided to create an informational system recording the non-alcoholic beverages and mineral drinks „in order to control (their) quality”. Such approach could not be efficient since it intends replacing the quality control at the company level by an administrative control of the entire branch. Other potentially disgraceful initiative is the emergence of a legislative project stating that all companies with foreign shares could be obliged to give up the land received either by inheritance or after the reorganization of enterprises. April was marked by symbolic events, too. Three investment funds („pillars of the Moldovan privatization”) were authorized to stop their activity on the capital market, and the law on leasing of 1992 was annulled.

The **industry** recession continued in March-April, although a bit slower. If in February 2007 the industrial output was by 17% lower than in February 2006, then in March 2007 – by 7.6%. The winemaking industry does not have any more room to fall, while a series of branches speeded up their growth (meat processing, vegetal products processing, non-alcoholic beverages production, chemical industry, furniture production). The textile industry growth remained on the January-February 2007 level (+16%). Although the situation in the industry of tobacco products improved slightly, this sector continued to register negative indexes. The rate of the extractive industry and the production of construction materials rise slowed down, anticipating probably the constructions boom decrease.

In April, the first independent forecast on the agriculture growth in 2007 (+4%) was declared. However, EXPERT-GRUP estimates that a growth by 6-7% is more likely. March-April frosts will influence the sector, but not critically. The re-opening of the Russian market for Moldovan vegetal products was followed by intense exports of the agricultural production, namely of the

apples stocked in refrigerators. In April, started also the honey exports to the EU, but on a low scale so far, due to the requirement to certify each exported lot. An important initiative was to raise from 60% to 80% the subsidies for agriculture risks insurance.

The companies from the **services** sector continue to profit from the households' strong inclination for consumption and from the output growth in several industrial branches. According to our estimates, in March the turnover in the retail sector increased by 12-15%, while the volume of services rendered to the population – by 8-9%. The telecommunications sector was marked by a series of events: the „Voxtel” company re-branding into „Orange” followed by a new variety of services; the declaration of Moldcell company to invest 84 million USD during next 4 years; first offers of lower tariffs; the National Agency for Telecommunications and Informatics' project to simplify the telephone users' „migration” from one to other operator without changing the telephone number. In March, the transportation services strengthen their recovery from the 2006 crisis (+8 as compared to 7.7% in January-February).

March statistical data on **prices** inspires a moderate optimism. After an inflation rate of 0.9% in January, and 0.7% in February, in March the consumption prices rose by 0.5% on average. Despite these positive tendencies, EXPERT-GRUP considers that we could speak about the inflationary risks' outrun only after the April inflation rate is announced. However, the National Bank of Moldova (NBM) is still optimistic regarding the inflation, proved by April relaxation of its monetary policy

On the **labor market** after a decrease of 5% in February, in March, the real salary rose by 8.8% (monthly rate). The beginning of seasonal works brought about a significant rise of salaries in agriculture, although the sector lacks labor force even more. In March, the salaries in the beverages industry rose slightly, while in education the situation remained the same, the salary being even lower by 8% than one year ago. However, a possible improvement would be noticed in the statistics for April. Paradoxically, but in April the financial sector registered a real salary decrease. This process evolves along with a rapid creation of new jobs and the constant inflow of young specialists to the banking system.

In March the **budget** was executed without significant changes. The global public revenues rose by 17% comparing to the planned level and by 37% comparing to March 2006. The management of expenses showed some progress. If in February the expenses execution



was 70% of the planned one, in March it reached the level of 77%. The expenditures planned for social insurance and assistance are executed perfectly; the government is very careful in this electoral period. The most ignored was the complex for fuel and energy, where the quarter expenses were executed, its quarter expenses were executed at the level of 37% of the planned one.

In April, the NBM Council of Administration adopted an important **monetary policy** decision lowering the basic interest rate from 14.5% to 13.5%. Although in the previous BERs the EXPERT-GRUP anticipated the lowering of REPO rate in 2007, after the explosive rise of industrial prices in February, the NBM decision seems to be somewhat hasty.

In April was published the report setting down the positive evolutions of the **banking system's** financial indicators in March. The amount of foreign investments in the banks' capital reached the level of 64%, as compared to 50% in March 2006. Although lower than in January-February, the profitability indicators exceeded the norms of 2006. The declining market share of the main five banks within the total actives per system from 69.42% in March 2006 to 66.86% in March 2007 points out the increase of banking competition.

The amount of disadvantageous credits of total credits did not change essentially: 4.15% in March 2006 comparing to 4.70% in March 2007. This proves that the banking system did not suffer much from the trade crisis with Russia and from industrial recession. At the same time, a minor trend of declining the banks' liquidity was noticed throughout the last year. Consequently, in April this determined the increase of competition for new deposits from population by more profitable interest rates and qualitative diversification of offers.

In April on the **financial markets** there was registered a slightly rising interest rate on T-bonds. Contrary to the previously dominant tendency, in April the demand at the auctions turned down and the first May auction only confirmed this tendency. The monetary sterilization, increasing inflows of the foreign currency from individuals and entrance of large foreign investments determined the Moldovan leu appreciation against the US dollar from 12.5414 on 1 April to 12.4107 on 30 April. The capital market was marked slightly by the religious holidays, and the amount of transactions in April exceeded by 17 % the amount of March. This dynamics stemmed mainly from the more intense activity of the joint-stock companies in the eve of the annual general assemblies of shareholders.

During the last period, the Moldova's **foreign trade** showed opposing trends. According to our estimations, in March the exports reckoned 270 million USD and the imports – 620 million USD. Moldova's trade diplomacy was active in promoting Moldovan products either through inter-governmental negotiations or through local companies attending important national and international economic events (the most international event was the Shanghai Moldovan wines and culture festival). However, the diplomatic efforts are less effective when internal barriers and deficiencies persist. In April the abusive interdiction of the bulk wine exports was lifted and the fruits and vegetable exports to Russia were extended. Nevertheless, there are a series of barriers to be removed.

On the **global markets** the oil price for WTI brand fluctuated between 60 and 65 USD/barrel. The second part of April was characterized by an ascending trend of the oil price due to the reduction of the oil reserves in the USA, the administrative attempts of "cooling" the Chinese economy and the new escalation of the geopolitical risks in the Middle East. The global wheat forecast for 2007/08 was reduced by 1 million tons down to 623 million and new negative revisions are likely in the future. At the same time, in 2007/08 is expected a growth in global production of barley up to 150 de million tons (+12 mln.) due to expansion of plantations in EU, Australia and Canada.

In **Russia**, the output rose in the first quarter by 7.9% as compared to Q1/06. The ruble appreciation and the rapidly rising salaries exert more competition pressure on Russian producers. These tendencies will favor the imports to Russia, and has to be exploited by Moldovan producers after the political and red-tape barriers for exports are lifted. In Q'07 the **Ukrainian** economy grew strongly too, by 8.0%; the political crisis had no considerable effect on the economy. The **European Union** continues to enjoy a positive economic trend. Although the data on the euro-zone economic growth have not been published yet, several indicators prove that the cheering economic trend persists. **Romania's** economy grew healthily in the Q1/07 too. At the same time, the current political crisis could undermine significantly Romania's economic perspectives. After suspending the president Basescu and in the eve of the forthcoming referendum (19 May), the Parliament approved some unplanned budgetary expenditure with clear electoral purpose that could increase the budget deficit to almost 7% of GDP.



## Regulatory framework

In April, a series of normative and legislative acts, which would influence significantly the business conditions emerged. Obviously, firstly we should mention the triple presidential initiative regarding the capital liberalization, fiscal amnesty and reforming the taxation on profit revenues that dominated throughout the April (for a more detailed analysis of this initiative see box 1). Moreover, we consider that in the next future the government could come with other economic surprises.

On the economic “revolutionary” background, other important events remained almost unnoticed, namely the decision of the Constitutional Court on the constitutionality of provisions included in the 5<sup>th</sup> point of the Regulation on the auto transportation of passengers and goods<sup>1</sup>. The regulation was adopted by the Government decision no.854 of July 28, 2006 and the 5<sup>th</sup> point prohibits using the re-equipped van-trucks for passengers’ transportation. According to the Regulation’s provisions, these vehicles would be removed from use gradually, depending on the year of production, so that all re-equipped vehicles would be excluded by the 2<sup>nd</sup> semester 2007. These provisions were contested at the Constitutional Court by a parliamentarian deputy, but the Court decided that the regulation does not go beyond the constitutional framework.

By adopting this decision, the Parliament has the chance to apply the regulation, while the owners of re-equipped minibuses rendering passengers transportation services would have to withdraw their vehicles from routes by the end of 2007. It is unimaginable how this process will happen. At present, over 1500 of minibuses run only on the routes within Chisinau. The application of this decision, even if perfectly constitutional, could have a series of economic and social consequences. The withdrawal of re-equipped minibuses and the purchase of new vehicles could cause a significant rise of tariffs on passengers’ transportation. At the same time, this decision will be followed by a “consolidation” of the ownership relations within the transportation sector, hence by the reduction of the number of independent providers of services.

It is noteworthy, that according to several unofficial sources, a big lot of vehicles has been already imported and it would be “proposed” to owners of the re-equipped minibuses. The governmental interventions could be followed by the social actions of transporters and drivers employed on routes, which will line up to the social

movements started in 2007 (teachers and patent holders).

April was characterized by emergence of many technical norms for harmonizing the normative framework with the European sanitary and veterinary legislation<sup>2</sup>, developed by the Ministry of Agriculture and Processing Industry. Curiously, all these norms (see 2<sup>nd</sup> footnote) had been already developed in 2006, but published only in April 2007. It has to be mentioned that during the last years the government was strongly criticized by both domestic and foreign experts for tergiversation in implementing the European sanitary standards. By publishing these norms, although late, Moldova pays its some important debts.

In April, the government decided to create an informational system recording the non-alcoholic beverages and mineral drinks „in order to control (their) quality”. This approach could be criticized for the intention to substitute the quality’s control on the company level by an administrative control of the entire branch. Other symptomatic evolution was the emergence of a legislative project stating that all companies with foreign shares could be obliged to give up the land received either by inheritance or after the reorganization of enterprises. This decision could generate an ample legal scandal, because the land was acquired legally, even if using the gaps in legislation. If the decision is applied, many investors would start thinking whether the legal principle “the law does not have a retroactive effect” works in Moldova.

In April other three investment funds received the agreement of the National Commission for Estate Values to stop their activity as professional agents on the estate market.<sup>3</sup> The investment funds took part actively in the privatization process of the ‘90s and their liquidation, as happens at present, suggests not only their failure in transforming into important players on the financial market, but the failure of the policy to enrich the people through them. The main result of the investment funds’ activity was the dispersion of the ownership rights to thousands of holders of deeds of a dubious economic value.

After in March the law on propriety of January 22, 1991 was abolished<sup>4</sup>, in April followed a new symbolic event,

<sup>2</sup> În Monitoarele Oficiale din luna aprilie au fost publicate trei norme sanitare importante: „Norma sanitară veterinară privind condițiile de sanitară veterinară la exportul și importul de păsări și ouă de incubatie”, „Norma sanitară veterinară privind condițiile de sănătate pentru producerea și introducerea pe piață a laptelui crud, a laptelui tratat termic și a produselor pe bază de lapte” și „Norma sanitară veterinară privind stabilirea metodelor de analiză și testare a laptelui tratat termic destinat consumului uman direct”.

<sup>3</sup> Este vorba de Fondurile Investiționale Nemutuale Nespecializate „Mandatar”, „Asito-Invest-Prim” și „DAAC-Hermes”.

<sup>4</sup> Legea nr.54-XVI din 2 martie 2007.

<sup>1</sup> Decision of the Constitutional Court of the Republic of Moldova no.6 of March 27, 2007.



the abrogation of the law on lease of January 14, 1992<sup>5</sup>. In the first half of the 1990s these laws were among the main pillars of the first-round economic reforms. Their abrogation is a proof of maturing Moldovan legislation and of advancing economic system.

### **Box 1. „Liberalize, liberalize and again liberalize”**

The new liberal initiative launched by the President of Moldova was intended to appear as a revolutionary one. At present, after a series of economic policy failures and external shocks bore in 2005-2006, the government needs regaining urgently the confidence of the business sphere. In this regard, the proposed reforms are really spectacular: capital legalization, financial amnesty and null taxation on the reinvested profit.

The null taxation on the reinvested profit raises least questions. This initiative deserves a support, at least for avoiding the double taxation on the same profit (firstly, when recording the company's profit and secondly, when sharing the profit among associates or share-holders). At the same time, this tool is also useful for cheering the investment process. The only question is whether the zero-quota is set forever or for a finite period. Moreover, it is noteworthy that for the majority of the businessmen the complex management of the Value Added Tax and the very big social insurance contributions are the main deficiencies of the Moldovan fiscal system. Thus, the main business expectations regarding a fiscal revolution are firstly, the simplification of the VAT system and the reduction of social insurance contributions, but these are missing in the new initiative.

The fiscal amnesty proposal is more debatable. The international instances provided by the government are less relevant, simply for the fact that they are not supported by rigorous research on the discipline effects of such initiatives. However, by a logical assumption, we can expect that in a country exiting the “wild capitalism” period, a fiscal amnesty would lead rather to worsening of the fiscal discipline, than vice versa. Especially, this will happen if the legally acting economical agents would interpret the fiscal amnesty of their competitors as an anti-competition plot.

The main objective of the fiscal amnesty has to be improving the future fiscal discipline. Three factors are required for achieving this goal: 1) consolidation of the fiscal management capacities; 2) nullifying the political connections between the state enterprises (the main fiscal debtors) and the government and 3) guaranteeing that no new fiscal amnesty in the future.

It is difficult to imagine that after January 2008 the tax collection capacities will improve essentially. This does not depend only on the fiscal officers' professionalism, but on the legal system's correctness and efficiency either. If, according to official data, at present 2.0 billion lei are “frozen” as the economic agents' fiscal debts which the tax office could not recover, what crucial institutional changes are required so that such debts would not accumulate anymore, and if accumulated would have been recovered? The government did not answer to this question yet.

Would the connections between the economical and political disappear also in the future? This will depend totally on both the government capacity to restrain from interventions, and the National Competition Agency (NCA) and justice capacity to enforce equal activity conditions for all companies, regardless of their form of property. When speaking about new fiscal amnesties, the majority of the cases prove that, once started, this practice become tempting for the governments of many countries.

The capital legalization is the most dubious of the three proposals. In each country and in every historical time, not the small entrepreneurs, but oligarchs and high public servants, which amassed and transferred abroad big fortunes, require capital legalization. The repatriated money is not directly reinvested, but enters most frequently the banking system. At the same time, the Moldovan banking system requires less additional resources, but rather attractive investment projects for existent resources.

Along with economic considerations, legal considerations should be highlighted also. Could we believe anymore in the rule of law, when the state's representatives themselves propose undermining the law? Is it the principle of unavoidable punishment still valid? And the crucial question, does the capital legalization imply the amnesty of frauds committed for its accumulation? The government did not answer coherently to these questions, too.

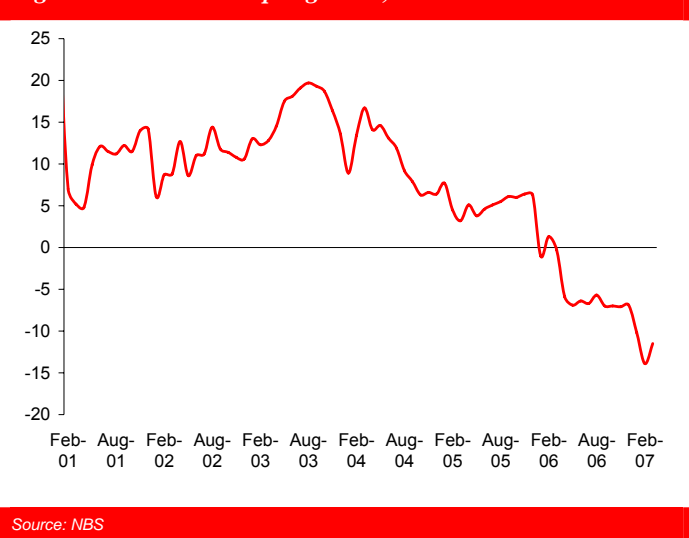
## **Industry and constructions**

The recession registered in the first quarter went on in April either. The persistence of this trend is fuelled by the uncertainty regarding the resumption of Moldovan wine exports to Russia, thus diminishing more the survival chances for many companies (see **Foreign trade**). Other reasons come from the innate weakness of the industrial system and do not have any link with the trade conflict with Russia. This weakness is attested also in the governmental evaluation of the social-economic

<sup>5</sup> Legea nr.83-XVI din 29 martie 2007.

situation in 2006, and the conclusions of this evaluation could be easily extrapolated to 2007 either.<sup>6</sup>

**Figure 1 Industrial output growth, %**



Although the industrial growth remained negative, in March the first tendency of reversing the descending trend appeared (Fig.1). The relative growth of monthly indicators as compared to cumulative indicators from the beginning of the year proves this thing. Thus, if in February 2007 the industrial output was by 17% lower than in February 2006, then in March 2007 – by 7.6%. At the same time, in the first quarter the cumulative industrial growth rose by 2 percentage points, as compared to the first two months of 2007.

The strong growth of several branches fuelled this dynamics. However, arithmetically speaking, this positive trend could be partially explained by the fact that a shrink by three-four time of the wine production throughout one single year does not anymore make room for falling. The wine producers do not have positive expectations regarding the re-opening of the Russian market anymore, what was evinced by the Moldovan wine companies' lack of interest to participate at the Russian wine exhibition "Krasnodar-EXPO". The situation when some winemaking companies financially incapable to return previously contracted bank credits were put in April up to sale highlights one more time the deepness of crisis within the winemaking sector. The majority of winemaking companies have an austere budget, and the available resources went for partial reimbursing or restructuring of the bank credits and for identifying new foreign partners. This is why the companies are not interested in symbolical initiatives, such as the "Wine Town" mega-project. Less than half of

the 40 plots of land auctioned within the project have been solicited so far. The wine producers become more aware of the necessity to orient the marketing toward abroad, while the resources and efforts should be assigned for participation at international events and exhibitions, not on local festivities.

In March several industrial branches performed better than in February. The growth sped up in important sectors, such as meat processing (+18% comparing to +5% in February) and fruits and vegetables processing (+22% comparing to +16%). This growth, to some extent, stemmed from the settlement of some trade disagreements with Russia and the resumption of vegetal and animal products, even tough on a narrow scale. The non-alcoholic beverages production registered a positive dynamics either (+43% as compared to +34%). The chemical industry grew by 47% as compared to +33% in February, mainly due to the rapid increase of production of medicines and pharmaceutical products. The furniture production grew by 23% comparing to +19% in previous period, but without any noticeable progress regarding its quality and the diversification of variety. This fact let's us conclude that the limits of the furniture production growth are quite narrow. The textile branch continued its strong growth, similar to the level listed in January-February 2007 (+16%).

Other three branches displayed an economic recovery as compared to January-February 2007 - footwear production (+5% comparing to -3% in January-February 2007), forage production (+0.3% comparing to -8%), the leather goods production (+10% comparing to -1%), paper and carton production (+0% comparing to -11%).

The negative situation in the industry of tobacco products has marginally redressed, but remains on a negative trend so far (-36% in January-February 2007 and -26% in the first quarter, in general). We have to mention that negative changes could happen within the tobacco industry and this is due to one of the biggest Ukrainian tobacco producers planning to open an official representative office in Chisinau. We are speaking about the German-Ukrainian company „Reemtsma-Kiev” that holds such famous brands as "Prima", "Slavutich", "Stolichnye", Boss, Davidoff, R1, West. The entrance of such player to the Moldovan tobacco market could be disastrous for local tobacco producers, as „Reemtsma-Kiev” do not seem to plan starting the production so far, but only to import and sale finite products.

The growth rate of the quarrying industry and the production of construction materials has slowed down (but remaining on high levels, +61%). This deceleration could be resulted from the expansive growth reaching its

<sup>6</sup> Government Decision no.384 of April 6, 2007 on the social-economic situation in 2006, Monitorul Oficial, 20 April 2007.



limits, and can be interpreted also as an indicator anticipating the constructions boom decrease.

Finally, we have to mention that after an economic growth in January-February 2007, in March the apparel production and fur processing branch and the industry of machinery and equipments listed a recession. In both cases the negative evolution apparently stemmed from the lack of long-term contracts and the difficulty to maintain stabile relationships with foreign clients and providers.

## Agriculture

In April the experts made their first evaluations on the agriculture's perspectives for 2007.<sup>7</sup> Evidencing that the first and second groups of grains turn out the winter well, the experts anticipate a growth of agriculture production by 4% in 2007. We deem that these estimations are chary and a growth of at least 6-7% could be expected. Our forecast is based on the repercussions of an economic growth return which is probable in 2007 after the 2006 recession, and not on the radical revival of agricultural sector.

This forecast could be undermined by both the state of viticulture sector, largely affected by difficulties of the wine producers (actually, the grape producers are in a more severe financial situation than the winemakers) and from technical cultures that in 2007 have a higher weight in the planted areas.

Due to resuming apples exports to Russian market, a major part of products stoked in refrigerators is actively exported. It is noteworthy that the temporary interdictions did not affect the popularity of Moldovan products in Russia and the demand for them is rising. After Russia banned the imports of Moldovan vegetable production, the niche held by our products was not practically filled, and the absence of providers able to deliver cheap products of mediocre quality (regretfully, Moldovan products have such an image) favored the current rising demand for Moldovan products.

In April, some amendments to the Law on the normative price for land and the Law on the land purchase-sale (see **Regulatory framework**) were put forward. The gist of these proposals was to forbid the individuals which are not citizens of the Republic of Moldova to purchase land plots. Furthermore, the individuals who inherited plots, indifferently of their destination, are obliged to alienate the property in behalf of some citizens of Moldova. In this situation, it is hardly to imagine that the foreign investments in agriculture will increase, and the consequences of such kind of decisions will not be long

expected. Actually, these initiatives are in opposition to foreign investors' expectations and could be a new serious obstacle in attracting foreign investments to the country. In this regard, we consider that there is rather a need to set up a normative framework for the conditions of a long-term use of land by both citizens of Moldova and foreigners.

The most important legislative amendments within the agricultural sector concerned the subsidies for agriculture. In April, the Law on the subsidy for insuring the risks in agriculture was amended. The revised law stipulates that 80% of the producers' insurance payments will be covered by the state budget. For this purpose, a sum of 15 million lei was allocated, but it does not cover completely the sector's needs. Taking into account the rising demand for insurance services and the obvious multiplication of the risks for agriculture, in 2008 a significant increase of the budget to around 25-30 million lei would be required.

The frosts from the end of March – beginning of April injured some fruits plantations and thus, negatively affected the evolution of the production process. At the moment, the extent of harms borne by local producers is unknown, but its significance is already obvious. Thus, we could expect high prices for peaches, apricots and other stone fruits in the next future.

In March the exports of honey to the UE started (see **BER 18**). In April, Moldova exported around 40 tons of honey, which represents a tiny quantity from Moldova's annual honey production of 2000 tons. Such low exports are determined by the requirement to certify each exported lot, while it would be normal to certify the entire process of production. This action would reduce the production costs and improve the product's competitiveness in the market.

Although in 2007 the main direction for honey exports was the Czech Republic, the likelihood to diversify the markets is real. Because the majority of producers do not hold enough quantities of honey to deal directly with the customers, the honey is exported through intermediaries who receive finally the value-added profits instead of honey producers. This financial aspect constitutes the main source of the Moldovan producers' modest interest in exporting honey.

However, since the honey consumption in Moldova is 40 grams/ per person yearly (15 times less than in the EU states), there is a high internal potential for honey sale, which is still not completely used by Moldovan honey producers.

<sup>7</sup> See „Experts make cheery prognosis for agriculture, but foresee a possible drought”, Economic Newspaper „ECO”, Wednesday, 11 April 2007.



## Services

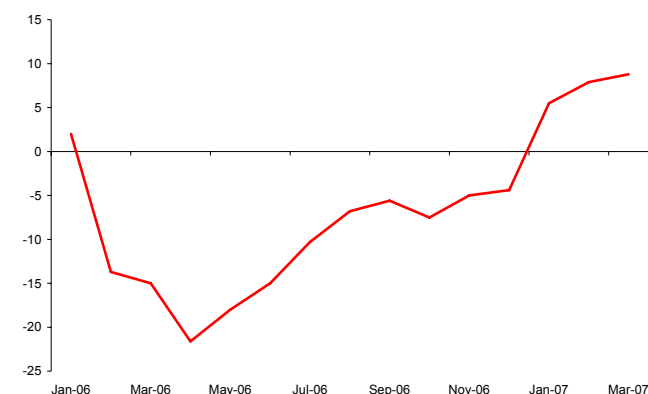
As long as the wage growth follows a positive trend and the revenues remitted by emigrants are rising, the consumption of domestic householders remained on high levels. EXPERT-GRUP estimated that in March the turnover in the retail sales sector rose by 15-16%, while the services rendered to the population by 8-9%.

In April the telecommunications sector was marked by two important press releases. „Orange” (former „Voxtel”) announced its intention to broadcast 4 TV channels through mobile phones. This represents a premiere for Moldova’ telecommunications market and could be considered an indicator of the sectors growing in quality. Other operator of mobile telephony, Moldcell, announced its intention to invest 84 million USD till 2011 in developing the quality and variety of the rendered services. At the same time, the first offers for decreasing tariffs have been noticed, as the pundits anticipated (see **BER 16-17**).

In April, the National Agency for Telecommunications and Informatics attempted contributing to the development of telecommunications market. In particular, the Agency proposed amending some acting regulations, thus that the telephone users’ “migration” from one operator to other would be possible without changing the telephone number. Obviously, these perspectives are favorable for the telephone users. At the same time, despite all client-friendly facilities, some operators within the market could interpret the Agency’s as creating unjust competitive advantages to other operators.

After a long-term recession, in April 2007 the transportation services showed recovery tendencies. (Fig.2). According to some estimations, the quantity of goods transported in April exceeded by 8% the quantity transported in April 2006., while the number of passengers remained unchanged.

**Figure 2 Growth of service of goods transportation, %**



Source: NBS

According to April declarations of the Ministry of Transportations’ representatives, the current situation on the inter-urban routes would change radically by removing the illegalities committed on a large level. In particular, the individuals performing this activity without any legal authorization would be punished more severe. Furthermore, the economic agents which do not give tickets to the passengers would be prevented or punished. Taking into account the frequency of the road police stopping the microbus’ drivers, it is easy to deduce that the amount of the illegal revenues received is halved. We consider that the Ministry of Transportations has to cooperate very close with the Ministry of internal Affairs in settling the issues of the sector that requires more transparency in its regulation.

## Prices

The statistical data on the monthly inflation in 2007 inspires moderate optimism. After an inflation rate of 0.9% in January and 0.7% in February, in March the consumption prices rose on average by 0.5%. This index looks also better than the 1.5% rate of inflation in March 2006. At the same time, the quarter inflation rate in 2007 registered a good level of 2.1% as compared to 4.8% in 2006. Furthermore, the evolution of industrial prices reverted to a normal level (+0.5%) after an outburst of 19.4% in February 2007. In regards to the categories of products and services, the most stable was the food price (+0.4%). The food price decrease by 0.1% was favored mainly by the declining prices for potatoes and dairy products. Among the non-food goods, the prices rose essentially for medicines (+2% on average) and apparel (+1.8%). The services price increase by 0.9% was caused by the administrative rise of tariffs on some utilities by 1.5%.

**Table 1. Monthly inflation rate, %**

	January 2007	February 2007	March 2007
Consumer price index	0.9	0.7	0.5
Food	1.4	0.4	-0.1
Non-food goods	0.8	0.2	1.0
Services	0.2	1.3	0.9
Industrial producers price index	1.3	19.4	0.5

Sources: NBS and NBM

Despite these positive tendencies, EXPERT-GRUP considers that the inflationary risks have not been completely outrun. April, and not March is the month that ends the first annual inflationary risky period (the second seasonal risky period is October-December). Thus, the spectacular lift of industrial prices in February was followed in April by a significant rise of prices for some goods and services. However, April appreciation of the



Moldovan leu against the dollar supported the reduction of inflationary pressures. For the moment, the cumulated effect of these influences can not be assessed correctly enough, but if the statistics on prices for April is positive, the NBM could take a pause until autumn.

The National Bank decision to reduce by 1 percentage point its base rate in April (see **Money**) proves the Bank's optimism regarding the prices evolution in the short run. Nevertheless, we deem that this signal was made too early.

## Labor market

The real salary increased by 9% in the first quarter, thus reaching the level of 1.870 lei (150 USD) in March. The March developments on the labor market differed from the February ones. The most important fact is that after a 5% decrease in the real salary reported in February, the average monthly salary increased by 8.8% in March.

Salaries in agriculture (+13.8%) and extractive industry reported the highest increase in March. The first case is explained by seasonal intensification of the field works, whereas the rapid increase in salaries in the extractive industry is determined by the strong growth in labor productivity in this sector that reports a record rate of economic expansion (see **Industry and construction**). At the same time, the development in the extractive industry will depend, to a great extent, on what is happening in the construction sector where the boom will not last forever.

Interestingly, in March, the situation of labor payment in food and beverage industry was marginally straightened out. Here, the real salaries were 11.6% and, respectively, by 4.7% higher comparing to March 2006. In case of winemaking, the improvement of labor payment to employed workers was possible due to the already undertaken dismissals of personnel. However, the situation did not change in the educational system where the real salary in March was 8% lower than one year ago. Nevertheless, April statistics might show the salary increase promised previously to the teachers by the government. The situation in the health system enhanced marginally.

The highest growth of the real wage in the economy (+24% comparing to the situation that was one year ago) is reported in the construction sector that is still holding top position among the most profitable sectors. However, as mentioned in previous issues (see **BER 16-17**) the maintenance of the sector's growth rate implies the diversification of supply from the building companies and developers, as well as the development of financial instruments aimed both at providers and those needing living space.

Curiously enough, it has been found that salaries paid to the employees from the financial sector decrease as real purchasing power! In March the average salary in this sector was 3,826 lei, comparing to 3,864 in March 2006. Taking into account the increase in consumption prices, this would mean a real decrease of over 10%. We are dealing thus with a less common development of the financial system, where the salaries, besides being the highest in the economy, were also growing constantly in real terms. One of the explanations of this situation might be the fact that bank managers can afford to negotiate tougher employment requirements due to the fact that there is constant inflow of young labor force that is willing to work. A confirmation of this hypothesis is that the number of employees in the banking sector increased in March 2006 – March 2007 by approximately 7%, this being one of the most rapid sectors from the point of view of the number of created work places.

## Budget

In March, there were no essential changes in the execution of public budget, perhaps with the exception that the levied revenues have accelerated comparing to the first two months of this year.

In the first quarter of this year, the public budget global revenues increased by 17% comparing to the planned level and by 37% comparing to the first quarter of 2006. Most categories of budget revenues were executed much higher than the quarterly plan. However, there should be mentioned significant deviations from the schedule in levying medical insurance, the deficit rising to 5%. In addition, the revenues derived from special incomes of the public institutions are levied slower than planned. This is the result of exaggerated optimistic estimates of these revenues and which did not take into account the decrease in the amounts raised by governmental institutions and agencies as a result of the regulatory reform in 2005-2006.

**Table 2. The dynamics of the national public budget**

	Planned L1-L3/07	Executed L1-L3/07	Executed L1-L3/06
Global revenues, MDL million	4201.4	4910.8	3576.6
Including, revenues from VAT, million MDL	1455.4	1542.7	1127.8
Including, income taxes accrued from business activity	352.9	550.1	308.5
Global expenditures, MDL million	5892.7	4527.7	3396.4

Sources: Ministry of Finance

As before in January-February, in March the expenditures were executed slower than planned, although there should be noticed a certain progress in expenditure management. In February, the level of

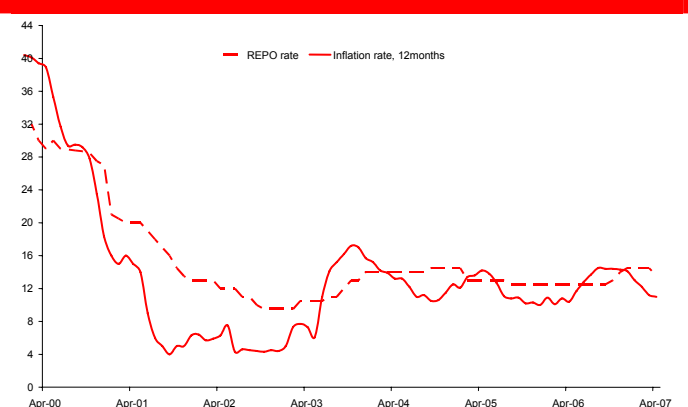
expenditure execution was under 70% of the planned level, whereas in March it reached 77%. The expenditures planned for social insurance and assistance are being executed almost irreproachably, this sector being very sensitive during the election period. The most suffering sector is the complex of fuel and energy where the quarterly expenditures have been executed at the level of 37%. In contrast to January-February, financial discipline is not flawless any more as regards the service of internal and external public debts. As result a surplus of about 385 million lei emerged in the budget.

As we have informed in **BER 18**, in March the Government highly appreciated the activity of the Ministry of Finance in 2006<sup>8</sup>, and, on the other hand, it gave directives to the Ministry to intensify efforts of levying the remaining budget revenues. This governmental decision once again denotes the fact that the initiative on tax amnesty, which is a part of the "liberal package" announced by the head of state on April 10 this year, was a total surprise for the Government, in general, and for the Ministry, in particular.

## Money

In April this year, the Board of Administration of the National Bank of Moldova decided to reduce the basic interest rate<sup>9</sup> (monetary policy interest) from 14.5% to 13.5% (Fig. 3). In the January issue of **BER-16** the EXPERT-GRUP anticipated such a development, but after the strong rise in prices of industrial producers in February, we were rather expecting a stricter monetary policy than vice versa.

**Figure 3. Development of year-on-year inflation rate and REPO rate**



Sources: NBM

<sup>8</sup> Decision of the Government no.315 of 19 March 2007.

<sup>9</sup> Rate applied for REPO operations of purchasing for the term of two months state securities carried out within the open market operation of the NBM.

As the monthly inflation decreases, the NBM decision seems correct to us, although a bit rash, due to the fact that certain inflationary risks still persist. (See **Prices**).

Apparently, inflation integrates perfectly in the monthly schedule necessary for reaching the target of 10%, wished by the Government and NBM. Nevertheless, we consider that currently the economy has accumulated a range of structural dysfunctions (See **Foreign Trade, Regulatory Framework**) that might generate inflationary outbreaks.

Obviously, the decrease in the basic rate would be a good signal for economic agents that are expecting a reduction of interest for the credits contracted from the commercial banks. However, the lack of confidence prevailing in the national economy might determine financial and banking institutions to be cautious in what concerns the eventual decrease in interest. After all, we may state that, at the moment, the decision of the NBM does not mean monetary relaxation. As long as the monetary policy will pay more attention to the volume of sterilization and effective interest on the market, the influence of the decrease in the basic interest rate will be modest. Probably, the central bank is giving a signal that, at the moment, the problem is not the inflation, but the leu's appreciation.

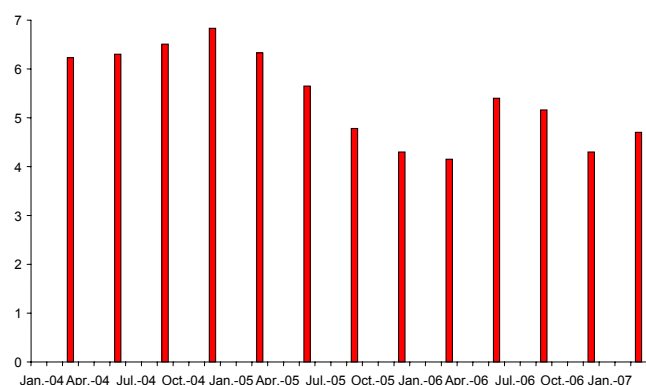
During the period of March 30 – April 27, 2007, the NBM intervened massively on the foreign exchange market. Sterilization operations (by means of currency purchases and open market operations) during this time period are estimated at 50 million USD. A proof in this direction is the fact that only in the period of 30 March – April 13 the NBM's currency reserves increased by approximately 30 million USD. Another explanation might be the fact that in this period the currency inflows from immigrant Moldovans were very high as volume as a result of bank transfers or migrants coming home for holidays. As a consequence, these led to the appreciation of leu against dollar and euro. If we resort to a comparative analysis, we will see that from the beginning of the year leu appreciated against the dollar by 5%, threatening to be a new shock for exporters. The impact will be even greater if the leu's growth of prove to be a lasting trend, because Moldova is transforming into an economy functioning mainly by imports which is risky in the long term.

## Banking system

In April, the NBM published the report on financial indicators of the banking system for the end of the first quarter. Comparing to the first two months of this year and the same period of the previous year, the trends of system's development are positive. The share of foreign investment in bank capital reached 64%, comparing to

50% in March 2006. The profitability of assets and capital slightly decreased in March comparing to January – February this year, thus repeating a seasonal pattern, but significantly increased above the levels achieved in March 2006.

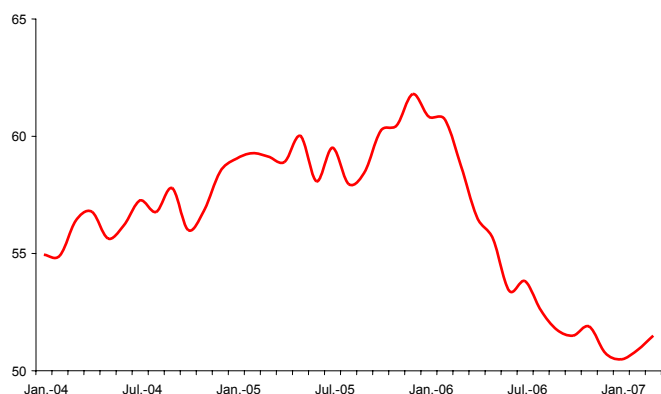
**Figure 4. Evolution of unfavorable bank credits, % from total credits**



Sources: NBM

Decrease in the share of the main five banks in the total of assets per system from 69.42% in March 2006 to 66.86% in March this year is a testimony of intensifying bank competitiveness. It is necessary to notice that the situation of unfavorable credits of commercial banks is not dramatically different from March 2006 (Fig. 4), when the winemaking crisis started as a result of which, according to certain experts, many bank credits were frozen in weak financial balance sheets of companies exporting wine to Russia.

**Figure 5. Share of Leu deposits in the total of bank deposits**



Source: BNM

It is true that the share of expired credits in the total of credits grew from 4.15% in March 2006 to 5.4% in June 2006, but after this it dropped up to 4.3% in December

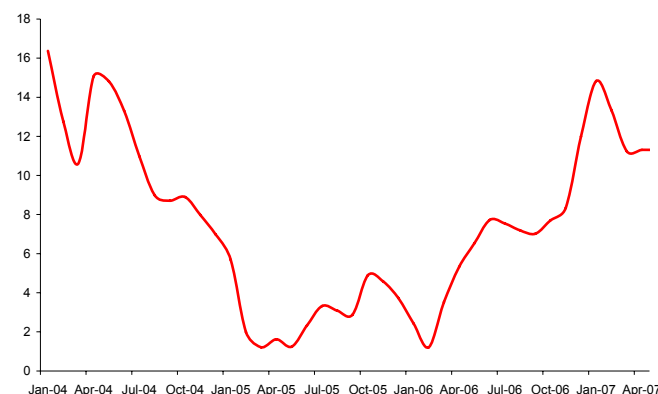
last year. In March this year, the share of these credits was slightly higher than in March 2006, of about 4.7%. At the same time, during the last 12 months there prevailed a slight trend of decrease in the level of liquidity in the banking system. As a result, the system reported the intensification of fight for attracting new savings from the population. In March – April, at least two large commercial banks constantly increased interest on population deposits. Although moderate, a certain effect of the application of these tools was noticed: the rate of leu deposits in the total of deposits grew from 50.76% in January this year to 51.50% in March this year, but is still low in historical terms (Fig.5).

At the same time, the efforts of attracting additional resources through the increase in interest were limited to only several banks. At systemic level, in March there persisted the trend of reduction in interest rates on deposits of population and economic agents (from 14.03% in January to 13.90% in March and, estimated 13.60% in April). In spite of cheaper resources, in March, the banks increased by 0.37 points the rates of credits nominated in MDL and by 0.04 points for credits granted in foreign currency, reaching the level of 18.69% and, respectively, 11.06%.

## Financial markets

The year 2007 began with a significant growth of the interest rate on state securities traded on the primary market followed by a decrease in the rates in February-March 2007 and a marginal increase in April which continued at the auction of May 2 (Figure 6).

**Figure 6. Average interest rate on T-bonds, %**



Source: NBM

Unlike the previous trends, the banks' demand at April auctions displayed clear decreasing tendencies consolidating at the first May auction. If at the auction of





3 April the aggregated demand of the commercial banks amounted to 89 million lei, then at the auction of 2 May the total demand was 54 million lei, while the supply of the Ministry of Finance equalled 50 million. The decrease in the interest of the banks towards state securities is explained by reaching a level of saturation with these assets after a period of rather intense procurements. Moreover, some banks feel a certain deficit of liquidities and this is the reason why they prefer to use the available resources for investment with maximum return. The T-bonds are only low-risk and do not provide high returns satisfying the banks.

In April, apparently, the inflows of foreign currency from physical persons have increased, as well as the intra-corporate credits from the foreign companies to their subsidiaries in Moldova. As result the period was featured by a trend of leu's appreciation against foreign currencies. While at beginning of April the USD/MDL exchange rate was at 12.5214, by the end of month it official exchange rate went down to 12.4107. As for the EUR/MDL exchange rate, it grew from 16.7117 on April 1 to 16.9238 on April 30. The latter was mostly the result of the euro-leu cross-quotation reflecting the global depreciation of the dollar against the European currency (see also **Global markets**).

Regarding the insurance sector, the only one, but very important evolution, was that the insurance law became valid after being published in the Official Gazette. The capital market was only marginally affected by religious holidays and the activity on the stock market was on the rise. According to official statements, the volume of transactions in April increased by 17%. This development was significantly influenced by the more intense activity of the stock companies in the wake of general assemblies of the stockholders in April-May. The trend of rising price for the stocks issued by the largest financial and non-financial institutions persisted in April. One should notice also the strong recovery of the stocks issued by the Moldova-Agroindbank after in March they fell dramatically. The increasing price of these stocks was largely influenced by the bank's intention to buy out its own stocks.

In April one interesting event, though not with immediate economic consequences, was the publication of the study "Growing economic sectors and opportunities for commercial leasing". The study was commissioned by two USAID-funded projects and proves the existence of a large potential for increasing the demand for leased agricultural equipment over the next two years. These results contradict the overt pessimism of the Moldovan financial institutions as regards the perspectives of economic growth in agriculture and may exert a considerable impact on the leasing agencies.

## Foreign trade

According to our estimates the Moldovan exports in January-March totalled 270 million USD, while the imports – 620 million. In April the foreign trade was featured by opposite developments. On the one hand, the efforts of the economic diplomacy sped up both in bilateral inter-governmental negotiations and in presence of Moldovan companies at economic events in the country and abroad.

On the other hand, the diplomatic efforts will not be so easily transposed in the real trade and the producers continue to suffer from certain external barriers and internal deficiencies. Further, we will try to outline the main tendencies on both sections.

Thus, the Republic of Moldova is very close to be provided the Autonomous Commercial Preferences by the EU. At the Forum of Businessmen in April 2007, the Moldovan President declared that these preferences could be provided even during the next 6 months. Within the same context, the Moldovan authorities requested an evaluation visit on behalf of the experts of the European Commission (DG SANCO) for the initiation of the export of a group of animal products (milk, eggs, meat) on the EU market.<sup>10</sup>

Moreover, at the beginning of May, the Republic of Moldova ratified the CEFTA agreement that, after the accession to the EU of Romania and Bulgaria, includes 8 countries: Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova, Montenegro, Serbia and Kosovo. The agreement is preliminarily ratified only by Albania and Bosnia and Herzegovina. However, we consider that this agreement will have a marginal commercial impact, taking into account the limited potential for the exchange of goods between Moldova and Western Balkan countries<sup>11</sup>.

The authorities and companies of Moldova have been also involved in a series of business forums that aimed at the intensification of trade and investment activity. The first event, the Moldovan-Italian Business Forum, was organised by the Ministry of Economy and Commerce, MIEPO, Chamber of Industry and Commerce and the National Italian Institute of External Commerce. The organisation of such a forum reflects the increasing share of the Italian market for the producers from Moldova, as well as the increased interest of Italian enterprisers for the investment opportunities in Moldova.

<sup>10</sup> Earlier the Ministry of Agriculture and Food Industry has approved the Veterinary Sanitary Norm on sanitary conditions for the production, trade with the EU member states and import from other countries of some food products and some unprocessed comestible products for company animals.

<sup>11</sup> Moreover, Croatia is in the process of negotiations on the EU accession with the tentative period of accession 2009 and, respectively, will leave this agreement as soon as the accession takes place.

The second event, "The Festival of Moldovan Culture and Wine" in Shanghai, aimed at promoting winery products of the Republic of Moldova on the markets of South-Eastern Asia. The program of the festival also included a series of meetings of Moldovan winemakers with winemaking and commercial companies from China, Hong-Kong and South Korea. The representatives of the companies from Hong-Kong and South Korea also requested the organisation of similar events in their countries. The efforts of promoting Moldovan wines on the dynamic markets of South-Eastern Asia could diversify significantly the commodity markets of our wines.

During April, there took place 2 more events that will contribute positively to the growth of Moldovan exports. It regards the increase in abusive banning of wine export in bulk and the extension of fruit and vegetable export to the Russian Federation.

Nevertheless, the decision on the renewal of wine export in bulk can have limited positive economic effects. Before this interdiction, during 2006, the largest volume of wine in bulk was exported to Belarus, Romania and Ukraine. Since 2007, the wine export in bulk to Romania became more difficult (due to its accession to the EU) and in Belarus it will be done only via a single mixed Moldova-Belarusian enterprise, a fact imposing some constraints on the exported volume. All these issues make us consider that in 2007 the wine exports in bulk will not accrue to the levels reached in 2006.

At the same time, the commercial relations with Ukraine can be adversely influenced by the effects of some political-territorial dissensions between Moldova and Ukraine. It regards the construction of the portal in Giurgiulești (by the Republic of Moldova) and the hydroelectric station in Novodnestrovsk. In the case of Giurgiulești, the Ukrainian part requests an evaluation of the impact on the environment as a result of implementing the project. As regards the power station of Novodnestrovsk, the situation seems to be more complicated. On the one hand, the Republic of Moldova tries to obtain the evaluation of the ecological impact of the construction of the power station. On the other hand, for the construction of the main reservoirs Ukraine requests the assignation of a land portion that belongs to the Republic of Moldova. These dissensions can transpose, among others, in new rise in price on electricity<sup>12</sup> imported from Ukraine that covers over 75% of internal consumption of the Republic of Moldova. In a middle-term perspective, these dissensions can influence negatively the commercial Moldovan-Ukrainian relations as well.

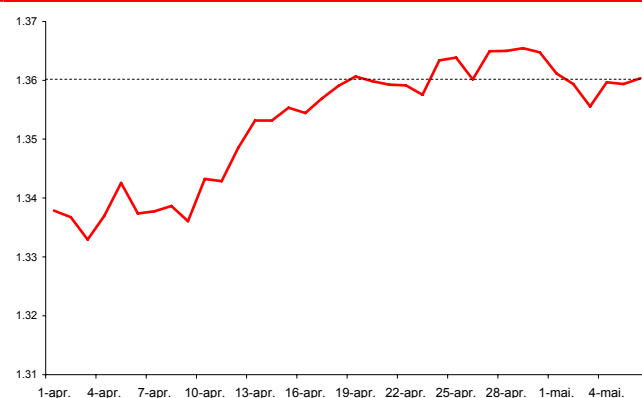
<sup>12</sup> The prices on imported electricity have increased by 9% already at the beginning of May.

## Global markets

During April, the **oil** price (WTI brand) swung between 60-65 USD/barrel. The evolutions in the oil price during the first half of the month have been, to a great extent, shaped by the geopolitical risks in the Middle East, especially by those related to Iran. The alleviation of these risks has determined a decrease in the prices by middle of the month from 64.5 USD/barrel to 62 USD/barrel. The second half of April was featured by a slight rise in prices. This increase has been influenced by a series of factors: decrease in the oil reserves in the USA (even though the oil fuel reserves indicated constant growth), attempts to moderate administratively the Chinese economic growth (with the corresponding impact on the demand for oil on this dynamic market), a new intensification of risks in the Middle East related to the prevented terrorist attacks on the pipelines in Saudi Arabia and perpetuation of tensions around the Iranian case. The geopolitical risks related to the Iranian nuclear case will not disappear in the nearest future and, thus, they will exert important influences on oil price<sup>13</sup>.

In April, the forecast for the global harvest in **grains** for the agricultural year 2007/08 has been reviewed and reduced by 1 million tons to 623 million tons. Moreover, these forecasts do not take into account the weather risks in the United States (cold winter), Europe, Northern Africa and China. The most considerable growth of production is expected in the EU, CIS, USA, India and Australia. The global consumption is forecasted to be 622 million tons. The industrial use of grains for the production of ethanol is also anticipated to grow to new facilities in Europe and Canada. Generally, if compared to the previous year, a growth of the demand on behalf of Morocco and Iraq, as well as the EU that will cover the additional needs by purchasing grains from the producing Black Sea countries.

**Figure 7. Euro/dollar exchange rate in April**



Source: Rosbusinessconsulting

<sup>13</sup> Sources: The Economist, International Energy Agency, Reuters, RBC.



Simultaneously, in 2007/08 the increase in the global production of **barley** is expected up to 150 million tons (+12 mil.), to a great extent due to the extension of plantations in the European Union, Australia and Canada. Instead, the global consumption has been reduced to 146 million tons<sup>14</sup>.

During April 2007, the **dollar** continued to depreciate against the **euro** (Fig.7), the exchange rate exceeding the historical threshold of 1.3660 USD/euro. Weakening of the dollar was also noticed against the Moldovan leu on Moldovan domestic market. Cheapening of the dollar was greatly caused by the fundamental indicators of vigor of the American economy. For example, data on consumer trust and real estate market are extremely important for the American economy supported by the increasing consumption expenditures have disappointed the investors.<sup>15</sup> In short term perspective, markets are awaiting the maintenance of the dollar weakening trend on the background of running risks of a stagflation in the United States. At the same time, some long term investors are anticipating a growth in attractiveness of the American currency in a somewhat distant future<sup>16</sup>.

## Trade partners

In **Russia**, statistical data for the first quarter demonstrate the persistent trend of economic growth. Thus, Russian economy grew in T1/07 by 7.9% comparing to T1/06. Similar to the first two months this growth was strongly supported by the increase in demand for investment (+20.1%), construction (+22.7%)<sup>17</sup> and high consumption demand. The latter was supported by the increase in real available revenues of the population (+13%), including the real salaries (+18.4%)<sup>18</sup>. The increase in salaries and revenues on the one hand, and increasing willingness of banks to provide consumption credits, on the other, have fuelled the expansion of retail trade by 13.6% in this period. The industrial production increased by 8.4%, being supported by positive development in the sectors of extracting (+4.2%) and processing (+14.5%) industry. Robust industry increase symbolizes the overturn of the leveling trend of industrial growth reported in 2006. The contribution of exports to economic growth continuously decreases (an increase of only 5.3% in T1/07), greatly reflecting the cheapening of oil on global markets. On the background of the increase in real revenues of the

population and investment demand, but also the consolidation of rouble, the imports have considerably increased, +36.8%. Rouble's appreciation, alongside the accelerated increase in real salaries, exerts greater competitive pressure on Russian producers. At the same time, these trends will further favor the expansion of imports into the Russian Federation, which, in a brighter future, might bring benefits to Moldovan exporters<sup>19</sup>.

In the first quarter of 2007, **Ukrainian** economy continued to grow strongly: +8.0% comparing to the same period of the last year with the political crisis having no major impact upon economic developments. This growth is based on the robust expansion of industry (+12.5%) and construction (+16.1%) sectors. Agriculture grew by 5%. The economic growth was strongly supported by the increase in the consumption demand. Retail trade increased by 25.8% being supported by the growth in available real revenues (+12.2, 02/07 comparing to 02/06).

Although, the effects of the political crisis have not spread in the economic system yet, the latter cannot function infinitely in such conditions. Therefore, the settlement of this crisis (either through anticipated elections or other solutions) will be the more beneficial the faster it is and, obviously, legal.

At the same time, the obvious lack of topics on economic policies in debates between the political opponents by no means implies a national consensus in this direction. However, the tax, land and pension system reform do not find proper place on the agenda of any politician involved in the conflict, and the negotiations are mainly focused upon the division of the power "pie" in Ukraine. Thus, the year of 2007 runs the risk of being lost for economic reforms<sup>20</sup>.

**Table 3. Economic indicators of main trade partners of the Republic of Moldova**

	GDP		Industrial output,	Inflation,	Unemployment
	Last data	2007, prognosis			
Russia	7.9 T1/07	6.3	8.4 T1/07	3.4 T1/07	7.2 03/2007
Ukraine	8.0 T1/07	6.0	12.5 T1/07	1.3 T1/07	6.7 2006
Romania	7.7 2006	6.5	7.4 01-02/07	3.7 03/07	7.8 03/07
Germany	3.7 2006	2.2	6.8 02/07	1.9 04/07	7.0 03/07
Italy	2.9 2006	1.7	-0.7 02/07	1.5 04/07	6.5 T4. 2006

<sup>14</sup> Sources: USDA, World Agricultural Supply and Demand Estimates, Wheat Outlook; International Grains Council, Grain Market Report.

<sup>15</sup> Real estate indicators, in fact, have reached the lowest level starting from January 1989.

<sup>16</sup> Reuters, RBC, Global Insight Inc.

<sup>17</sup> Strong increase in construction was favored by exceptionally warm weather conditions for this period of the year.

<sup>18</sup> Nevertheless, the speed of real salaries expansion exceeds that of productivity, which might have adverse effects on the competitiveness of Russian producers.

<sup>19</sup> Ministry of Commerce and Economic Development, Институт Экономии Переходного Периода – Institute of Transition Economy.

<sup>20</sup> Інститут економічних досліджень (Institute for Economic Research and Policy Consulting), Міжнародний центр перспективних досліджень (International Centre for Policy Studies), Експерт-Україна (Expert-Ukraine).



Sources: *The Economist*, IMF, World Bank, Derjkomstat, Goskomstat, Eurostat, INS Romania, EXPERT-GRUP.

**The European Union** continues to be in the bright zone of global economy. Data on Euro zone economic growth have not been published yet; however several indicators show that the trend of economic reinvigoration persists. Thus, the industrial output increased by 4.1% (02/07) on an annual basis; in March the unemployment reported a slight decrease up to 7.2%, and retail trade intensified by 2.6%. Notably, in the category „foodstuffs, beverages and tobacco” the increase in the retail trade intensified in the Euro zone by 2.1% on the whole, but slowed both in Germany (-0.7%) and Italy (-1.7%, 02/07). In short term perspective, such risks as price rise and strong euro (making European exports more expensive) may shadow the positive economic dynamics in the euro zone.

Our estimates show the persistence of robust economic growth in **Romania** in the first quarter of 2007 as well. This is reported by a range of such factors as: increase in industrial output (+7.4% in 01-02/07), expansion of the construction sector (+32.8%, 03/07) and retail trade volume (+4.3%, T1/07).

At the same time, current political crisis in Bucharest may significantly shadow Romania’s economic perspectives. „Activism” of Bucharest legislative body was already felt by adopting certain unforeseen budgetary expenditures (and, to a great extent, having electoral aspect before the May referendum). Experts estimate that these expenditures might add other 4 percentage points to the previously planned 2.8% of budget deficit for 2007. In a longer term perspective, dismissal of President Băsescu might signal to foreign investors the slowing down of judicial reform and slackening of the fight against corruption.

Romania’s international image will also have to suffer. An important signal is that the US State Secretary Condoleezza Rice refused to receive the new Minister for Foreign Affairs of Romania, and NATO summit planned for the next year in Bucharest will take place elsewhere. At the same time, failure to impeach and the come-back of President Băsescu will not facilitate the collaboration between the Legislative body and the President’s Office<sup>21</sup>.

<sup>21</sup> Sources: Săptămâna Financiară, Capital, The Economist.



